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SUBJECT: SOUTH AFRICA ECONOMIC NEWSLETTER

May 13 2005 ISSUE

**¶11.** Summary. Each week, AmEmbassy Pretoria publishes an economic newsletter based on South African press reports. Comments and analysis do not necessarily reflect the opinion of the U.S. Government. Topics of this week's newsletter are:

- Barclays Deal Only Waits for Shareholder Approval;
- Reserve Bank to Manage Rand Impact;
- Barclays-ABSA Deal Could Halve Current Account;
- Exchange Reserves Shows Small Change;
- South Africa's Governance High in Some Areas; Less Stable in Others;
- Tourism Charter Announced; and
- South Africa Improves its Competitiveness Ranking.

End Summary.

BARCLAYS DEAL ONLY WAITS FOR SHAREHOLDER APPROVAL

**¶12.** Britain's Barclays Bank made a final offer of \$5.5 billion for control of South African bank ABSA, marking its return to South African retail banking and the biggest foreign direct investment in the country. The deal only awaits shareholder approval expected on June 13. The UK bank's long-awaited announcement is a major vote of confidence in the South African economy more than a decade after the demise of the apartheid regime and 19 years after Barclays' forced exit from the country. Britain's third-biggest bank will pay R33 billion in cash for 60 percent of ABSA, South Africa's biggest retail lender. After eight months of talks, Barclays is offering R82.5 a share and ABSA will pay its shareholders a dividend of R2 a share. Finance Minister Manuel's approval of the deal confirms that Barclays has agreed to meet the government's conditions to the acquisition. The conditions, outlined in the National Treasury's statement, are that ABSA remain a locally listed company with its primary listing on the JSE Securities Exchange, and that Barclays maintain ABSA's board make-up in the sense that ABSA's chief executive and the majority of the executive management remain South African citizens. Barclays has agreed to meet or exceed all the black economic empowerment targets in the financial sector charter, and the South African Reserve Bank will remain the lead regulatory authority for ABSA. The approval represents a shift in the government's "four-pillar" policy. Manuel said last year that the country maintained a "four-pillar" policy of having a minimum of four big, locally owned banks to ensure effective competition. However, a National Treasury statement issued on May 8 said approval of the Barclays deal was consistent with the policy. The four-pillar policy remains in place, with the only difference being that ABSA, as one of the four pillars, will now have a foreign majority shareholder. Negotiations between the two banks, first made public in September, intensified over the past four weeks. Malcolm Hewitt, the managing director of Barclays sub-Saharan Africa and Indian Ocean, said that Barclays operated in 12 African countries. If the ABSA deal went through, it would have a presence in 13 or 14 countries. Barclays initially bid R79 a share and increased its price to win over minority shareholders. After the transaction is sealed, Barclays will make about a third of its profits outside the UK, up from about 20 percent now. The purchase is Barclays' biggest step so far in a plan to double its share of profit from outside Britain to diversify risk and expand in higher-growth markets. Source: Business Report, SAPA, Business Day, Reuters, May 9.

RESERVE BANK TO MANAGE RAND IMPACT

**¶13.** South Africa will seek to ensure that the R33 billion purchase of ABSA Group, the nation's biggest consumer lender, by Barclays would not have a "negative impact" on the rand, Treasury Director-General Lesetja Kganyago said yesterday. Kganyago said the Reserve Bank "will in the normal course of its business deal with the management of the inflows." Finance Minister Trevor Manuel told reporters, "what you and I don't know is how much of this

transaction has been discounted" in the value of the rand. As Finance Minister he "couldn't take a view on the currency." Source: Business Report, May 9.

BARCLAYS-ABSA DEAL COULD HALVE CURRENT ACCOUNT DEFICIT

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**14.** According to ABSA economist Christo Luus, Barclays' proposed acquisition of 60 percent of ABSA could finance half of South Africa's current account deficit for the year. British bank Barclays has offered about R33bn for a stake in ABSA, while South Africa's current account deficit for 2005 is forecasted at R68 billion. The anticipated 2005 deficit would be about 4.7 percent of gross domestic product (GDP), which is historically high, Luus said. Between 1994 and 2004, foreign direct investment (FDI) into the country averaged about R10.7 billion a year, or 1.2 percent of annual GDP. Net FDI was even lower at 0.7 percent of GDP per annum. Between 1999 and 2004, total FDI was R121 billion. The rand could remain stronger which would contribute towards the inflation target continuing to be met and lessen the need for much higher interest rates. However, about R1 billion in dividend payments would accrue each year to foreign shareholders, negatively affecting the current account. However by improving domestic business opportunities, investment and growth, the deal may reduce the desire of both resident and foreign shareholders to repatriate dividend income. South Africa's low ratios of gross domestic saving and gross fixed capital formation as a percentage of GDP (14.9 percent and 15.8 percent, respectively) could therefore be boosted by between one and two percentage points. Source: SAPA, May 9.

EXCHANGE RESERVES SHOWS SMALL CHANGE

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**15.** The South African Reserve Bank (SARB) continued its conservative purchasing of foreign reserves in April, increasing by \$156 million. Total reserves now amount to \$14.3 billion. Analysts were keeping an eye on the figures to see if sterilization of the inflow of foreign exchange from the Barclays-ABSA deal had already begun, but the relatively small increase in foreign exchange reserves suggests that it has not. When Finance Minister Trevor Manuel announced on Sunday that the deal had received regulatory approval, SARB Deputy Governor Xolile Guma said the dollar proceeds would be absorbed into official reserves to minimize disruption to local financial markets. Economists now expect this month's figures to show a large rise in foreign exchange reserves, reflecting the Bank's purchase of dollars flowing in from the deal, which would otherwise cause an unwelcome strengthening of the rand. The latest figures suggest that, even though the Bank had indicated its preference for a more competitive rand and expressed concern about the effect of its strength on certain economic sectors, it was not seeking to influence the rand's value through more aggressive reserves buying. Source: Reuters and Business Day, May 10.

SOUTH AFRICA'S GOVERNANCE HIGH IN SOME AREAS; LESS STABLE IN OTHERS

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**16.** The World Bank issued its latest "Governance Matters" report comparing governance indicators among 209 countries. Six components of good governance are highlighted: (1) voice and accountability, measuring political, civil and human rights; (2) political instability and violence, measuring the likelihood of violent threats to, or changes in, government, including terrorism; (3) government effectiveness, measuring the competence of the bureaucracy and the quality of public service delivery; (4) regulatory burden, measuring the incidence of market-unfriendly policies; (5) rule of law, measuring the quality of contract enforcement, the police, and the courts, including judiciary independence, and the incidence of crime; and (6) control of corruption, measuring the abuse of public power for private gain, including petty and grand corruption. According to the report, South Africa is slightly less politically stable than most other countries. However, in other areas of governance South Africa remains well above the world average with a significant improvement in the category of government effectiveness over the past seven years. The report places countries in categories which reflect their variation above or below the world average. South Africa's political stability is placed at -0.24, below the world average of 0, the same as Argentina. At one end of the scale, Iraq is at -2.87 in terms of political stability, Zimbabwe at -1.86. The U.S. is at 0.47, and at the opposite end of the spectrum, the Caribbean island of St Kitts and Ben Nevis is at 1.41. While the bank said that some of its more than 350 data sources on more than 209 countries were based on perceptions, they constituted

important sources of information. In its assessment of political stability, South Africa has moved considerably closer to the world average since 1996, largely due to a drop in political violence. The categories where South Africa scored towards the top of the first two quartiles above average include: voice and accountability; government effectiveness; the regulatory burden on business; the rule of law; and control over corruption. However from 1996 to last year, it slipped slightly in the areas of the rule of law and control of corruption.

Source: Business Day, May 10.

#### TOURISM CHARTER ANNOUNCED

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17. Environment and Tourism Minister Marthinus van Schalkwyk announced a black economic empowerment (BEE) charter for tourism that would encourage increased BEE ownership. A survey done in 2003 showed there was an average of only six percent BEE ownership in the tourism industry. The charter has seven broad indicators including ownership, strategic management, employment equity, skills development, preferential procurement, enterprise development and social development. It also contains measurement tools to help participants in the industry identify their current BEE levels and how to improve their ratings. The charter will apply to every single enterprise in the tourism value-chain. All businesses with an annual revenue of less than R5 million (\$820,000, using 6.1 rands per dollar) will be exempt from the ownership requirements, although the six other empowerment targets will still apply. Being rated would not be compulsory but there would be incentives to implementing the BEE targets. Ratings would be used by government in determining spending partners and for investment and development funding allocations. The charter would be implemented over two periods -- the first for the five years to 2009 and the second during the period to 2014. The BEE ownership target for 2014 was 30 percent. Van Schalkwyk said a BEE Council would be established and the transformation charter would be filed by August 1. Source: SAPA and Business Report, May 9.

#### SOUTH AFRICA IMPROVES ITS COMPETITIVENESS RANKING

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18. The World Competitiveness Yearbook, compiled by Swiss business school the Institute for Management Development, ranks the 60 most influential world economies. The 2005 Yearbook ranked South Africa at 46th position, reversing a trend that saw its rating decline from a peak of 37th in 2001 to 49th in 2004. The report warned that South Africa's high unemployment and HIV/AIDS rate remained the biggest obstacles to improving its ranking, emphasizing the need for greater urgency in government's efforts to encourage labor force participation. Although South Africa was rated last of the 60 countries when it came to unemployment, it rated second when it came to job growth. Since only 25 percent of the population was working, this job creation came off a low base. By contrast, 58 percent of Germany's and 46 percent of the UK's populations were employed. The list was headed by the U.S., Hong Kong and Singapore, while China dropped seven places to 31st, due to a negative opinion survey conducted in the business community. South Africa's best performance was in the area of government efficiency, where it was ranked at 32nd, higher than countries such as Germany, India, Japan, Belgium and France. Its poor infrastructure ranking lowered the overall score where South Africa ranked 58th, down from 56th last year, above only Mexico and Indonesia.

Source: Business Day, May 12.

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